

# Weekly economic update

14 August – 20 August 2006

Last week started with comment from finance minister Stanisław Kluza that fiscal deficit in 2009 should reach around 3.5% of GDP. This implies that Poland would not fulfil its obligations to reduce fiscal gap below 3% until 2009, not to mention that initially Polish authorities declared the threshold will be reached in 2007. The market was not affected by the comment, possibly because of the fact that significant delay in euro zone entry has already been priced in by the market. The market was also unaffected by suggestions of deputy PM Andrzej Lepper that budget spending should be higher given high GDP growth. Calm reaction of the market to such statement may be explained by the fact that even Self-defence leader assures that budget anchor, assuming budget deficit at maximum PLN30bn, should be maintained. As long as GDP growth is high, budget anchor is enough to dispel market's doubt about fiscal policy.

As regards domestic data releases, last week brought only balance of payments statistics for June – they showed surpluses on C/A and trade accounts and thus supported the zloty. The nearest week will be much more busy in terms of data releases. We will see the first set of monthly indicators for July: CPI, PPI, average wage and employment in the enterprise sector, output figures and monetary statistics.

## Economic calendar

Time GMT	COUNTRY	INDICATOR (importance level*)	PERIOD		FORECAST		LAST VALUE
					MARKET	BZWBK	
<b>MONDAY (14 August)</b>							
12:00	POL	Money supply (M)	Jul	%YoY	12.5	12.4	11.8
9:00	EMU	Preliminary GDP (H)	Q2	%YoY	2.3	-	2.0
<b>TUESDAY (15 August)</b>							
	POL	Public holiday					
12:30	USA	PPI (H)	Jul	%MoM	0.4	-	0.5
13:00	USA	Net capital flows (H)	Jun	\$ bn	70.3	-	69.6
<b>WEDNESDAY (16 August)</b>							
12:00	POL	CPI (H)	Jul	%YoY	0.8	0.8	0.8
12:00	POL	Wages (H)	Jul	%YoY	5.2	5.8	4.5
12:00	POL	Employment (H)	Jul	%YoY	3.2	3.2	3.1
12:30	USA	CPI (H)	Jul	%MoM	0.4	-	0.2
12:30	USA	Core CPI (H)	Jul	%MoM	0.3	-	0.3
12:30	USA	Housing starts (H)	Jul	m	1.81	-	1.85
13:15	USA	Capacity utilisation (H)	Jul	%	82.6	-	82.4
13:15	USA	Industrial production (H)	Jul	%MoM	0.5	-	0.8
<b>THURSDAY (17 August)</b>							
9:00	EMU	Final HICP (H)	Jul	%YoY	2.5	-	2.5
9:00	EMU	Industrial production (M)	Jun	%YoY	3.9	-	4.9
16:00	USA	Philadelphia Fed index (H)	Aug		10.5	-	6.0
<b>FRIDAY (18 August)</b>							
12:00	POL	Industrial production (H)	Jul	%YoY	14.3	12.5	12.4
12:00	POL	PPI (H)	Jul	%YoY	3.0	2.9	2.8
13:45	USA	Michigan index (H)	Aug		84.0	-	84.7

\* Importance level: (H)igh, (M)oderate; Source: Reuters, BZ WBK

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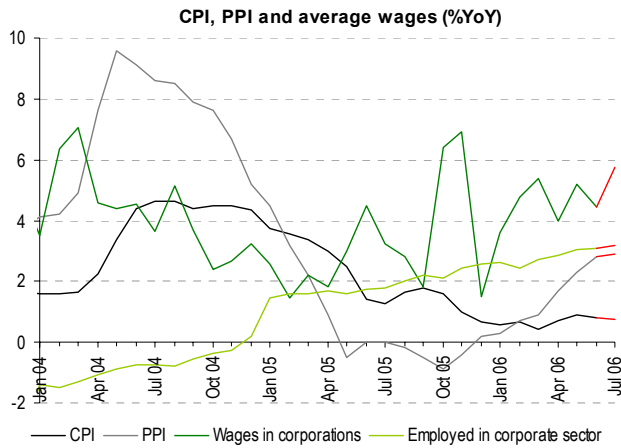
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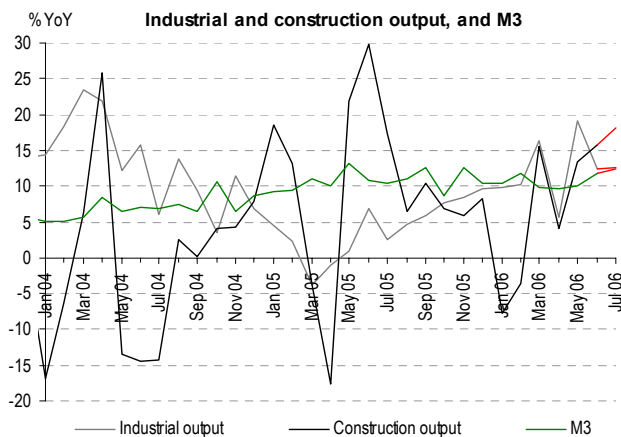
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## What's hot this week – A lot of market-sensitive data

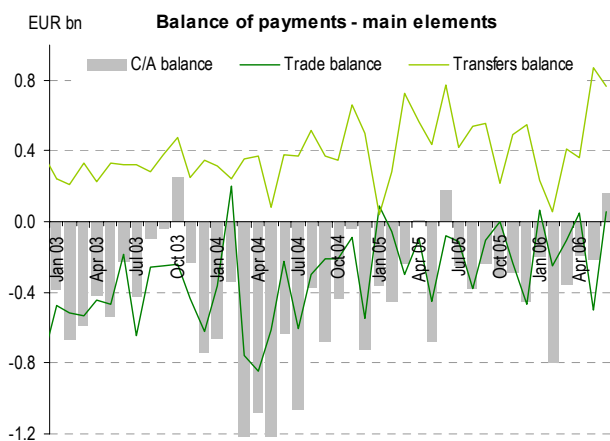


- On Wednesday the CSO will release data on average wage and employment in enterprise sector and on Friday we will get output and PPI figures.
- We predict that inflation in July remained at June's level of 0.8%YoY, showing that inflationary pressure is still subdued and confirming scenario assuming constrained inflation acceleration.
- From the point of view of inflation prospects, labour market statistics will be important. We expect that average wage growth accelerated, but the scale of the acceleration will still not be excessive (e.g. given pace of labour productivity growth). This was also indicated by data on average wage growth in the whole economy in 2Q06. The data showed 4.7%YoY increase, the same as a quarter earlier. Thus, it is still hard to talk about excessive wage pressure.



- Output figures for July should be confirm strong expansion of the Polish economy. Taking into account various information, we think the risk for our forecast is on the upside. The Ministry of Finance has not recently had accurate forecasts of output (contrary to their inflation estimates), but this time around it is likely that FinMin forecasts at 15%YoY will prove right.
- We also predict high growth in construction output, which would suggest that investment activity is gradually gaining strength.
- The least important for the market will be monetary statistics, especially that they will be revealed on Monday, during the long weekend. We expect the data will show further revival in credit activity and will be consistent with rising economic activity in Poland.

## Economy last week – C/A and trade surpluses



- Balance of payments statistics for June were better than expected. The market expected nearly C/A gap of €200m and trade deficit of ca. €100m, while the actual data showed C/A surplus of €160m and trade surplus of €61m.
- A disappointment is the fact that growth in foreign trade turnover decelerated stronger than expected, but exports and imports growth rates are still very high. What is important, exports still rises faster than imports (16%YoY versus 13.8%YoY) which is the main reason for narrowing of external imbalance.
- Transfer account again proved higher than we predicted. This stems from gradually mounting wave of EU funds and rising transfers of income of Poles working abroad. On services account a surplus of €196m was recorded and while on income account a gap of €863m were noted.

## Quote of the week – Economy grows, unemployment falls

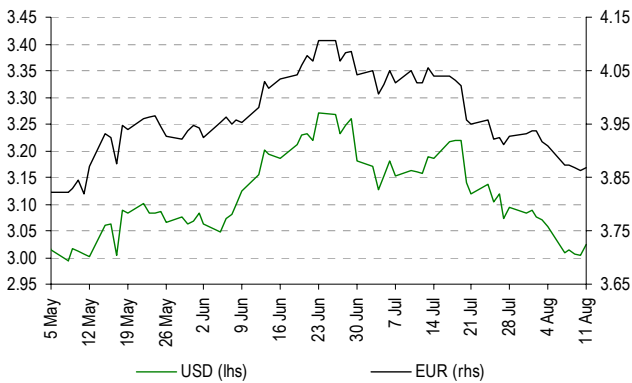
**Bogdan Socha, deputy labour minister; PAP, 10 August**

*Looking at tendencies in the labour market in recent three months and given signs of rising labour demand, one may expect the registered unemployment rate to fall by 0.5pp to 15.2% at the end of August. So far, we have forecasted that the unemployment rate at the end of the year will reach 16.2%, but if high economic growth and high labour demand are maintained, we do not exclude that the unemployment rate in December will be 1 pp lower than in our earlier predictions and reach 15.2%.*

If current predictions of the labour ministry for August materialises, this would suggest that GDP growth in 2H06 may be higher than 5% predicted by us at present. Strengthening of downward tendency in the unemployment rate will positively affect households' income and consumers' confidence and thus add to consumption demand. If this is accompanied by stronger investment activity and continuation of good results in foreign trade, there will be asymmetric risk on the upside to our forecast of GDP growth in the second half of this year.

**Market monitor**

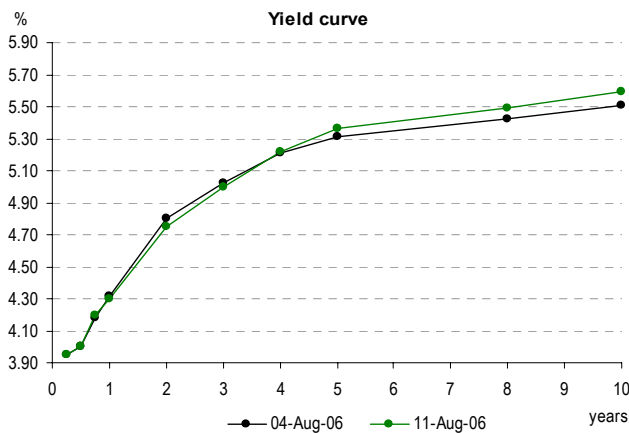
**Zloty exchange rate**



**Zloty strengthens again**

- At the beginning of the week zloty traded in a narrow range of 3.86-3.88 against the euro. Fed left rates unchanged, which effected in no major strengthening of the emerging markets currencies, as such a move was to some extent discounted in the prices, whereas the communiqué did not exclude further hikes. At the end of the week there was a slight correction with regards to threat of terrorist attack in London. During the week zloty strengthened by 1.1% vs. the euro and 0.6% vs. dollar.
- After several sessions of significant strengthening there may come a correction. Investors may seek some signals to sell zloty and such sign might be US inflation as well as housing market data, if it appeared above expectations. The EURPLN rate may fluctuate in range of 3.84-3.94, while the USDPLN of 2.97-3.07.

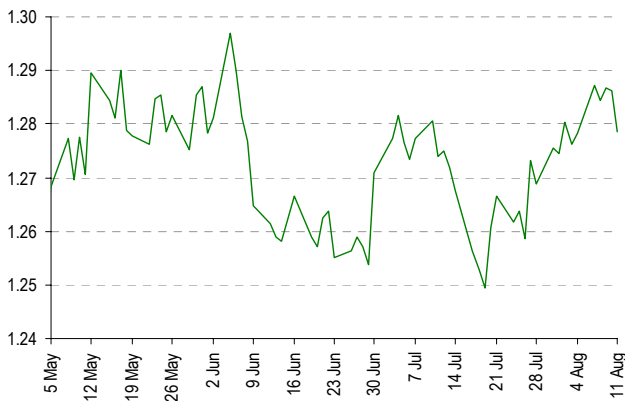
**Yield curve**



**Yields almost unchanged**

- Bonds slightly strengthened on expectations of Fed's rates decision. The FOMC's communiqué included expressions, which left the door open for further monetary tightening, which resulted in a slight correction in the core markets and also affected the domestic market. Since last Friday yields remained almost unchanged and moderately fell at the longer end of the curve.
- With reference to the tone of the FOMC's statement the US inflation data will be very important for the core markets and indirectly also for the Polish market. This week will be full of domestic data as well. Investors will focus on the CPI in the prospect of limiting expectations for rate hikes in next several quarters. Labour market statistics and production data will be also important.

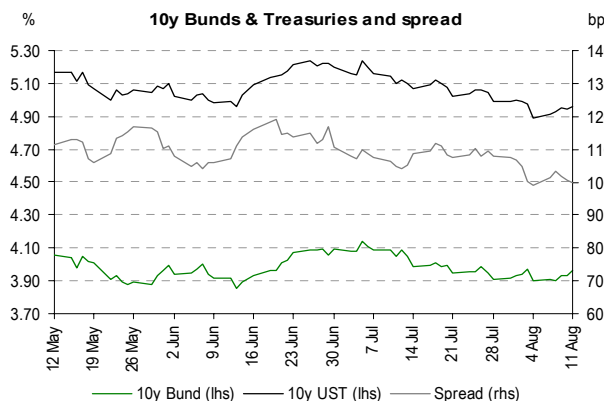
**EURUSD rate**



**Dollar's recovery**

- At the week's start the greenback appreciated vs. the single currency though weakened again before the Fed's decision. In the first reaction to the FOMC's communiqué the dollar strengthened, however later on the euro recovered. As this move was not convincing enough for investors there was a profit taking and greenback's appreciation below 1.28. This was also supported by the situation in Great Britain and US retail sales figure.
- It seems that the EURUSD rate is going to feature quite high volatility in reaction to released figures (especially on the state of US economy (housing market, production, activity indices) and inflation data (CPI, PPI), as well as net capital flows figure. The data affecting the rate hikes expectations may be important for the EU-12 again.

**10y Bunds & Treasuries and spread**



**Weakening in the core markets**

- After the Fed's decision the market slightly strengthened, though the communiqué gave a signal to correction. The events in UK effected in flight to quality and strengthening of Treasuries though another weakening occurred after US retail sales. Since last Friday 10Y US yields rose from 4.91% to 4.95%, while 10Y Bunds' yields from 3.91 to 3.96%.
- Inflation data in United States is going to be key for the core bond markets. In our opinion this is the end of the monetary policy tightening in US in this cycle, however with inflation staying at elevated levels and good economic data the market may start to believe in hikes again. The HICP figure and the situation in the US market may be important for the euro zone.

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